

IRS CIRCULAR 230
(Eff. 6-20-05 and modified thereafter)

PURPOSE/APPLICATION: Provides ethical standards for attorneys, accountants and other tax professionals practicing before IRS and attempts to provide a framework and enforcement authority to curb abusive tax avoidance transactions. Practitioners who violate the rules may be censured, suspended or even disbarred (§10.52).

RELIANCE OPINIONS: Any written communication that recommends or suggests that a client would prevail on a significant federal tax issue meets the broad definition of a reliance opinion. A significant federal tax issue is one in which the IRS has a reasonable basis for a successful challenge. **There is no materiality threshold and no dollar threshold that exempt written communications falling under this definition.**

While the recommendation must involve a plan or arrangement that has a significant purpose of tax avoidance to constitute a reliance opinion, one must remember that transactions can have a principal business purpose but also a secondary significant tax avoidance purpose. Thus, practitioners should be advised that successfully defending an argument that their written recommendation did not involve a significant purpose of tax avoidance may be hard to do. **As such, any written communication containing a recommendation to a client on a “gray area” topic that could reasonably be challenged by the IRS as a reliance opinion should (1) follow the covered opinion standards; or (2) contain an appropriate disclosure.**

A. **COVERED OPINION STANDARDS:** To meet the covered opinion standards, a written communication must contain a complete recitation of:

- (1) All factual matters;
- (2) The relationship of the law to the facts;
- (3) An evaluation of significant federal tax issues;
- (4) An overall conclusion; **and**
- (5) A disclosure of any scope limitation and disclosure if the opinion does not reach a “more likely than not” confidence level for success.

B. **IRS CIRCULAR 230 DISCLOSURE NOTICE:** (See sample notice below). Written advice can avoid the “covered opinion” standards by prominently disclosing (in a separate section in similar size type face) that the communication is not intended to be used, and cannot be used by the taxpayer, for the purpose of avoiding penalties that might be imposed on the taxpayer.

NOTE: This disclaimer alternative is not available if the written advice involves a “listed transaction” or the principal purpose of tax avoidance or evasion. The definition of the principal purpose of tax avoidance or evasion is similar to the definition contained in Treas. Reg. 1.6662-4(g)(2)(ii) which governs the substantial understatement penalty for tax shelters. The standard applies if the tax avoidance purpose exceeds any other purpose.

IRS CIRCULAR 230 -- DISCLOSURE NOTICE: IRS Circular 230 regulates written communications about federal tax matters between tax advisors and their clients. To the extent the preceding correspondence and/or any attachment is a written tax advice communication, it is not a full “covered opinion”. Accordingly, this advice is not intended and cannot be used for the purpose of avoiding penalties that may be imposed by the IRS regarding the transaction or matters discussed herein.

In addition, the materials communicated herein are intended solely for the addressee and are not intended for distribution to any other person or entity, or to support the promotion or marketing of the transaction or matters addressed herein. Any subsequent reader should seek advice from an independent tax advisor with respect to the transaction or matters addressed herein based on the reader’s particular circumstances.

LISTED TRANSACTIONS
(Per IRS Notice 2004-67)

The following is a list of transactional topics determined by IRS to be “listed transactions” subject to the covered opinion standards of IRS Circular 230. Any correspondence (written, e-mail, etc.) concerning these topics must be reviewed to assure compliance with the covered opinion disclosure requisites of IRS Circular 230.

Description	Authority
1. Transactions in which taxpayers claim deductions for contributions to qualified cash or deferred arrangements or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the tax year.	Rev. Rul. 90-105; Rev. Rul. 2002-46; Rev. Rul. 2002-73.
2. Trust arrangements purported to qualify as multiple employer welfare benefit funds or VEBAs, typically involving life insurance contracts and asserting use of the 10 or more employer plan exemption limit for welfare benefit plans.	IRS Notice 95-34.
3. Transactions involving contingent installment sales of securities by partnerships in order to accelerate and allocate income to a tax-indifferent partner, such as an exempt entity.	ASA Investorings Partnership v. Comm., D.C. Cir., 2000).
4. Transactions involving substantial short-term distributions from charitable remainder trusts.	Reg. 1.643(a)-8.
5. Transactions involving the distribution of encumbered property in which taxpayers claim losses for capital outlays.	IRS Notice 99-59.
6. Transactions involving fast-pay arrangements, in which dividends received represent a return of investment.	Reg. 1.7701 (l)-3(b).
7. Transactions involving the acquisition of two debt instruments, the values of which are expected to change significantly at about the same time in opposite directions.	Rev. Rul. 2000-12.
8. Transactions generating losses resulting from artificially inflating the basis of partnership interests.	IRS Notice 2000-44; Reg. 1.752-6T.
9. Transactions involving the purchase of a parent corporation's stock by a subsidiary, subsequent transfer of the purchased parent's stock from the subsidiary to the parent's employees, and eventual liquidation or sale of the subsidiary.	IRS Notice 2000-60.
10. Transactions involving Guam trusts under IRC Sec. 935.	IRS Notice 2000-61.
11. Transactions involving the use of an intermediary to sell the assets of a corporation.	IRS Notice 2001-16.
12. Transactions involving a loss on the sale of stock acquired in a Section 351 incorporation with a high basis asset and the corporation assumption of a liability unrecognized by the transferor.	IRS Notice 2001-17.
13. Redemptions of stock in transactions not subject to U.S. tax in which basis is purported to shift to a U.S. taxpayer.	IRS Notice 2001-45.
14. Transactions involving the use of a loan assumption agreement to inflate basis in assets acquired from another party in order to claim losses.	IRS Notice 2002-21.

Description	Authority
15. Transactions involving the use of a notional principal contract to claim current deductions for periodic payments made by a taxpayer, while disregarding the accrual of a right to receive offsetting payments in the future.	IRS Notice 2002-35.
16. Transactions involving the use of a straddle, a tiered partnership structure and similar economically offsetting positions.	IRS Notice 2002-50; IRS Notice 2002-65
17. Transactions in which a taxpayer purports to lease property and purports to immediately sublease the property back to the lessor (lease-in/lease-out).	Rev. Rul. 2002-69.
18. Arrangements involving the transfer of ESOPs that hold stock in an S corporation to qualify for the delayed effective date of IRC Sec. 409(p).	Rev. Rul. 2003-6.
19. Arrangements involving leasing companies to avoid or evade federal income and employment taxes under offshore deferred compensation arrangements.	IRS Notice 2003-22.
20. Arrangements that purportedly qualify as collectively bargained welfare benefit funds excepted from the Section 419 account limits.	IRS Notice 2003-24.
21. Transactions involving compensatory stock options and related persons to avoid or evade federal income and employment taxes.	IRS Notice 2003-47.
22. Transactions in which one participant claims to realize rental or other income from property or service contracts and another participant claims the deductions related to that income (i.e., "lease strips").	IRS Notice 2003-55.
23. Transactions that use contested liability trusts to accelerate deductions for contested liabilities.	IRS Notice 2003-77.
24. Transactions in which a taxpayer claims a loss upon assignment of a futures contract to a charity, but fails to report the recognition of the gain when the obligation under the offsetting contract terminates.	IRS Notice 2003-81.
25. Transactions designed to avoid the limitations on contributions to Roth IRAs, such as by understanding the value of a newly-formed corporation transferred to a Roth.	IRS Notice 2004-8.
26. Transactions that involve segregating the business profits of an ESOP-owned S corporation in a QSub, so that rank and file employees do not benefit from participation in the ESOP.	Rev. Rul. 2004-4.
27. Arrangements in which an employer deducts contributions to a qualified pension plan for premiums on life insurance that provide death benefits where proceeds revert to the plan as a return on investment.	Rev. Rul. 2004-20, Situation 2; Rev. Rul. 2004-21; Rev. Proc. 2004-16.
28. Transactions in which, under a pre-arranged plan, a domestic corporation purports to acquire stock in a foreign target followed by a Section 338 election and sale of target assets, generating a gain for foreign purposes but not U.S. purposes.	IRS Notice 2004-20.
29. Transactions in which S corporation shareholders transfer the taxation of S corporation income by donating S corporation non-voting stock to an exempt entity while retaining the economic benefits of the stock.	IRS Notice 2004-30.
30. Transactions in which corporations claim inappropriate deductions for payments made through a partnership, usually involving debt within an exempt but related foreign entity.	IRS Notice 2004-31.

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31. Sale-leaseback arrangements (sale-in/lease-out) transactions or SILOs, in which a taxpayer enters into a sale-leaseback with a tax-indifferent or exempt party.	IRS Notice 2005-13.
32. Transactions in which a taxpayer uses offsetting positions with respect to foreign currency or other property for the purpose of importing a loss, but not the corresponding gain, in determining taxable income.	IRS Notice 2007-57.

NOTE: For updates to this list, go to the IRS web page at

www.irs.gov/businesses/corporations

click on or search Listed Abusive Tax Shelters and Transactions. Notices and other published guidance will continue to be used to identify transactions that have been determined by IRS to be “listed transactions.”

EXCEPTIONS TO COVERED OPINION STATUS

1. **Written advice issued after a tax return is filed:** Written advice provided to the taxpayer solely for the taxpayer’s use setting forth the tax benefits of the transaction. **NOTE:** Such advice is **not** excluded if the practitioner knows, or has reason to know, that the taxpayer will rely upon the written advice to take a position on a return (filed after the date on which the advice is provided) that claims tax benefits not reported on the original return (e.g. amended return).
2. **Advice provided by taxpayer’s in-house counsel (employee):** In-house written advice solely for the purpose of determining the tax liability of the employer.
3. **Negative advice:** Written advice indicating that a federal tax issue will **not** be resolved in the taxpayer’s favor. **NOTE:** The exception does **not** apply if the advice indicates that there is any possibility of success at **any** confidence level (e.g. not frivolous, realistic possibility of success, reasonable basis or substantial authority with respect to that issue).
4. **No significant federal tax issue:** The “principal purpose definition does **not** apply if the written advice concerns an arrangement that has as its purpose the claiming of tax benefits in a manner consistent with a statute and Congressional purpose”. Accordingly, any written recommendations to merely use techniques such as credit shelter trusts, GRATs (grantor retained annuity trusts), CRTs (charitable remainder trusts), retirement plans, etc. which are authorized within a tax statute are not subject to the covered opinion requirements. **Written communication that is a mere factual recitation of a clear point in the law does not represent a covered opinion, due to the lack of ability of IRS to have a reasonable basis to challenge the advice.**
5. **Educational materials (including articles, training outlines, presentations and books):** While practitioners and taxpayers may often refer to such materials in formulating a view as to the actual consequences to a specific taxpayer of a given transaction or situation, these materials are not themselves “advice”.
6. **Transactional and/or operative agreements:** Documents setting forth the parties’ understanding of tax matters, covenants regarding how parties will perform tax reporting actions, tax indemnity provisions, certain partnership agreement provisions or organizational documents such as articles of incorporation do not constitute “tax advice”. These agreements are binding agreements between the parties to the transaction, not advice from the practitioner.

CHANGES CONCERNING §10.34 OF CIRCULAR 230

§10.34 has undergone substantial revisions in 2007 to account for the amendments in other areas of Circular 230. On September 26, IRS issued final regulations regarding changes to §10.34. IRS later realized that these changes would result in a lower standard of conduct for preparers under Circular 230 than under the Internal Revenue Code. Thus, IRS issued proposed regulations amending §10.34 to become final on January 1, 2008.

§10.34 sets out standards for preparing and signing returns with respect to preparer tax return positions. The rule focuses on the “realistic possibility standard,” where IRS takes the position that a practitioner must not sign a tax return as a preparer if the return contains a position that does not have a realistic possibility of being sustained on its merits if challenged by the IRS. The only exceptions to the rule are if the position is not frivolous *and* the position is adequately disclosed to the IRS.

The final regulations of September 26, modify §10.34 slightly, changing lettering on subsections and reserving the IRS’s position with respect to paragraph (a) of §10.34. A new paragraph (b) was also added, dealing with documents, affidavits, and other papers, expanding the IRS’ reach beyond just tax returns. In Circular 230, the IRS now takes the position that a practitioner may *not* advise a client to take a position on any document submitted to IRS unless the position is not frivolous. The purpose of the document may not be to delay administration of the tax laws and it may not omit or contain information that “demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.”

The current final regulations also modify subsection (c) regarding penalty advice to encompass the IRS’ expanded reach beyond tax returns. Thus, the practitioner must inform a client of penalties that are “reasonably likely” to apply to them with respect to a position taken on a tax return or on any document, affidavit or other paper submitted to IRS.

The proposed regulations (to become final January 1, 2008) extend the application of the “more likely than not” standard in §10.34 to make §10.34 consistent with revisions in I.R.C. §6694. Thus, a tax preparer would be subject to penalty under both provisions. As proposed, §10.34(a) states that a preparer may not sign a tax return unless there is a “reasonable belief” that the tax treatment on the return would “more likely than not be sustained on its merits” and there is a reasonable basis for the position that is adequately disclosed to IRS.

The “more likely than not” standard is defined in §10.34(e)(1). Under that provision, a practitioner may sign a return if, after examining the facts and authorities, the practitioner can reasonably conclude in good faith that there is a “greater than 50% chance” of the tax treatment being upheld under an IRS challenge. The types of authority a tax preparer may base their opinion on are the code, other statutory provision, proposed, temporary, and final regulations, revenue rulings and procedures, tax treaties, court cases, and congressional intent.

“Reasonable basis” is also defined in the proposed regulations as a belief based on one or more of the above-listed authorities. The return must not be frivolous, patently improper, and must not be “merely arguable” or “merely a colorable claim.”

Interestingly, IRS did not deal with nonsigning preparers in the proposed regulations.